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Washington, D. C.,

November 10, 1916.

My dear Dr. Miller:

You were good enough to send me on October 23rd a copy of your Indianapolis speech and an appendix containing some thoughts of yours which you did not think it opportune publicly to express at this time but which you submitted to the Board members for the purpose of bringing about a general crystallization of views concerning this most important topic of note issue and reserves.

In going to the great trouble of reducing to writing our thoughts upon this subject, even though we disagree - or possibly because we disagree on certain points - you and I are rendering a valuable service, for, as you correctly say, the time has come when, after an existence of more than two years, the Board has to take a definite position upon problems which are of so vital a nature and concerning which our banks are now entitled to definite guidance and instruction, one way or the other.

It is for this reason, and not for the pleasure of a controversy, that I think it my duty to analyze your speech and point out, with brutal frankness, where you and I are not in accord. The members of the Board, I believe, want to have both sides of the case presented as fully as possible before finally making up their minds.

Before taking up your argument, let me compliment you upon the admirable way in which you have presented it. While I differ from you as to some of your conclusions, I certainly could find no fault as to the form. You made a splendid presentation and you will have to bear with me if I do not attempt to equal your paper as to polish and style. But time is pressing and I shall confine myself simply to enumerating and discussing the various objections as they occur to me.

You are in accord with me as to the main objective of my recent address - that it is our duty to prepare our banking system so as to enable us to withstand large withdrawals of gold.

Let me say right here that I do not consider myself qualified to act as a prophet. I do not know whether at the end of the war gold will be withdrawn at all. Nobody can say that today, because it will depend upon the question whether or not the credit of the now-belligerent countries at that time will still be strong enough to draw gold; and that, again, will depend upon the further duration of the war. On the other hand, it may be that we shall have to lose a great deal of gold. My contention is, not that we shall or shall not lose gold, but that it is the duty of a Federal reserve system to forearm in a manner that will enable us to lose gold without creating unnecessary convulsions. That we can protect ourselves and stop gold withdrawls in case they should work havoc with us, I have no doubts. But what I wish to avoid is that we should be forced to do so unnecessarily early, because it would mean that, to our own detriment, we should have to force up our own money rates and that we should have to stop granting credit facilities to other countries. I believe, however, that, having grabbed so large a share of the world's gold and wealth, we should consider it our moral duty to stand prepared to open our doors wide and contribute a phenomenal share in the work of reconstruction and construction that will have to be done after the end of the war.

I have, therefore, little sympathy with your argument that if we prepare to lose about $600,000,000 of gold that we have done our duty. If we should have to lose those $600,000,000 - (the arbitrary amount which you take as the basis of your argument because it happens to be the net accretion of gold at this time, though in a few months it may amount to much more) - our gold reserve on the basis of your calculation would have shrunk to 35 or 40%, respectively. You and I are in complete accord that that reserve is the minimum; but a minimum which should not be reached and which could not be considered satisfactory or a safe basis for our banking structure. If we reached that point we should certainly have to stop granting any further facilities outside of the United States, contract credits at home, and try by all possible means to re-establish a higher and safer basis of note and deposit gold cover.

My contention has been that we should be prepared to lose $500,000,000 or $600,000,000 of gold and still have $200,000,000 or $300,000,000 "free gold" in reserve, so as to keep intact our own credit machinery in case these gold exports should occur in these large proportions.

Your point of view is that it is safe enough to begin to hustle to secure these missing two or three hundred million dollars of gold when the emergency arises.

My experience as a banker makes me distinctly disinclined to rely upon that course. I believe that Governor Strong in his letter to you has admirably shown how little reliance in this connection we could place upon voluntary cooperation of our thirty thousand banks. When our reserves are down to 35% they will not be so eager to give us their gold in exchange for Federal reserve notes, particularly in times when gold is the one thing that other countries will draw from us and that we, at such time, will not be eager to part with.

And again, if you have in mind a situation such as that at the beginning of this war, you will observe that critical times - particularly during complications that spring up suddenly - bring about increased demand for currency. During those times the banks pay out a lot, but the volume of currency that is paid into the banks and for which alone gold circulation at that time could be substituted, is very unimportant, if at all existent. You have, of course, in mind the illustration of the issue of $470,000,000 additional currency in 1914. If during a critical period a determined appeal should be made to the public to turn in its gold, it might lead to increased alarm and panic, unless we were involved in a situation similar to that governing France and Germany where they were dealing with a national emergency and plainly appealing to the patriotism of all citizens.

But frankly I cannot quite understand why you should have taken exception at all to my point of view. When you figure out why we are strong enough to meet emergencies you rely on three items: One, our actual gold reserve taken from the member banks' deposits; two, the amount now impounded with the Federal Reserve Agent; and, three, the increased balances to be kept with Federal Reserve Banks produced by transferring member bank vault money to such Federal Reserve Banks.

As to the process under No. 2, in trying to prove that we are strong enough at this time you base your argument upon $120,000,000 of free gold which the member banks may rely upon, owing to the fact that they have impounded more than $200,000,000 of gold with Federal Reserve Agents. You recognize this method as necessary and advisable in its present scope. You do not object to its being continued as, as a matter of fact, it has got to be, provided the present indirect methods are applied. You also approve that this method of exchanging Federal reserve circulation for gold circulation be fully legitimized and pushed as far as it can be in case your $600,000,000 should prove an insufficient reserve, hence, as a matter of fact, you have sanctioned the process in the past; you sanction it in the présent and you rely upon it for the future. And I am frank to say that I do not quite see why you should consider my plan as a process of "artificial shifts and manipulations" "distorting and disfiguring our banking system to its own prejudice and to the prejudice of the country's real interests". As a matter of fact, you approve of the principle and disagree only as to the question of degree, taking it upon yourself to say that a definite amount is sufficient at this time while in other parts of your speech you say yourself that "it will be prudent, in making our calculations, to take note of the possibilities as well as the probabilities, particularly as the latter are so incalculable". However, I would be quite willing to leave your contentions unchallenged and allow nature to take its course if I were not so fully convinced that your process under No. 3 would be practically nullified by your disinclination to legitimize fully and modernize the issue and use of Federal Reserve notes. Practical experience will show you very promptly that, no matter how hard we may try to have our member banks increase their balances with Federal Reserve Banks by transferring a substantial share of their vault money, this will not be accomplished until they may count a reasonable amount of Federal Reserve notes as reserve. Our present deposit structure of member banks is too gigantic to make them either willing or feel justified in operating with a supply of till money which would merely respond to their average till requirements. Every conservative bank must be in a position to pay out promptly, without the least bit of hesitation, a very substantial portion of its deposits. They will, therefore, wish to have at their immediate command, without any possible delay, a substantial amount of currency. No doubt they would be willing to rely upon Federal Reserve notes for satisfying their depositors and would be quite willing to keep in their vaults, let us say, an amount equal to about 3% of their deposits. But they cannot afford to do this, because their sending of the corresponding 3% of their gold to the Federal Reserve Bank as additional balance would mean that they would carry, not 3%, but 6% in order to provide this amount of available currency in Federal Reserve notes. That is something the banks will never do. It is a loss which would appear to them entirely unnecessary and unwarranted, and would simply mean that that amount of gold will be kept in their vaults.

You will answer that this may be correct so far as the banks are concerned which are not located in Federal Reserve cities and that banks that are in Federal Reserve cities would afford to rely upon their ability to send across the street to their Federal Reserve Bank and get currency, and that, therefore, these member banks could reduce their cash holdings to the amount which is actually required for daily till uses. That would be correct, but it will not work out that way in practice. As a matter of fact, experience shows that the strong banks in London, Paris and Berlin keep a large amount of till money in order to be prepared immediately to meet all emergencies without being forced to send outside of their building, and it also must be borne in mind that these very strong institutions have a sbrt of pride in not applying too frequently to the central banks. Normally, they like to keep their investments and collections so well balanced that additional cash requirements can be taken care of by collecting a larger proportion of their daily maturities. In our case, that would mean that while the strong member banks may keep large excess balances they will keep part of this excess in their own vaults. Or, if their excess balance with the Federal Reserve Bank is being drawn down or withdrawn, their excess vault money acts as a supplement to their Federal Reserve Bank balance. If in that case they had Federal Reserve notes in reserve it would be necessary for them to send them over to the Federal Reserve Bank and convert them into a balance because otherwise these notes would be useless as reserve, and, under the circumstances, it stands to reason that they will rather hold on to a comfortable amount of gold or gold certificates. But there is another reason for their doing so, and that is that as long as the law makes this differentiation between Government obligations, calling the gold certificate, the silver certificate and the greenback first class money and the Federal Reserve note second class money, the member banks will feel a greater degree of safety in commanding the first class money then the second class. The sifting process will, therefore, continue and the large banks will have some kind of a subconscious feeling that as long as the Federal Reserve Banks are paying in currency that is second class and not worth to the member banks as much as what they would consider real first class money that the Federal Reserve Bank balance too is not quite as good as their gold. Moreover, these strong banks, on which a great many correspondent banks still rely, and which are by law obligated to keep the higher reserve of 18% for the very reason that, to a large extent, they are the correspondents of banks, would have a feeling of apprehension lest their gold placed in the Federal Reserve Banks would be used for the protection or credit expansion of the entire country, so that their actual gold reserve would be watered while the thousands of country banks would hold on to their gold. In other words, it would be a one-sided proposition which would not appeal to the banks in the Federal Reserve cities and would militate against the carrying out of your plan. This is a most important feature which you must not overlook. It will prove to make your entire program illusory.

But, even if your program could be carried out on the very basis that you appear to have in mind, I would personally consider it a very unfortunate one. The policy of the entire Federal Reserve System in that case could be controlled by the strong banks in the central reserve cities. If at any time the Federa; Reserve Bank became aggressive in a way that would annoy them they could at once collectively reduce the operating power of the Federal Reserve Banks by withdrawing their excess balances and putting them back into their own vaults.

My plan of securing an overwhelming amount of gold for the Federal Reserve Banks by withdrawing it from circulation and making every citizen of the United States who carries a note in his pocket permanently a would-be depositor of the Federal Reserve Bank, would free the Federal Reserve Banks from the exclusive control of their large member banks. Incidentally, as I have tried to show in my previous paper, it would immensely strengthen the power of our system and the confidence that it would command, not only at home, but also abroad.

You appear to think that the process proposed by me would lead to a "distortion of our gold standard". Nothing could be more unwarranted than such a thought. In my previous paper, I tried to show as plainly as I could that we must differentiate between reserves of member banks and reserves of central banks. Unfortunately, this point of view has been completely left out of consideration in your paper.

The gold standard is not affected at all by what I propose to do. Quite the contrary, my plan has for its very object to mass under our control the gold running wild in our country so that we may better protect our gold standard. If your plan could be carried out, there would remain in the vaults of the member banks only 2% in till money and all the rest would go into the Federal Reserve Banks. This 2% would amount to about $175,000,000. I fail to see why $175,000,000 of Federal Reserve notes placed in the vaults of member banks and against which a minimum of $70,000,000 of gold must be held with Federal Reserve Banks, permitting a net possible inflation of $250,000,000, should frighten you so and justify you in trying to combat a development - which otherwise can only redound to the greatest benefit of the entire country and

and would, as a matter of fact, secure the independence and growth of the Federal Reserve System - if, on the other hand, you are quite willing to let the total reserve required of about $1,275,000,000 be carried as balances with the Federal Reserve Banks upon which theoretically they could build an additional note issue of about two billions. But we need not be afraid of securing that much. We shall neither get all the gold held in member banks' vaults, nor more than a substantial percentage of the gold now in circulation; but, without the proper recognition of the Federal Reserve note, we will not begin to secure a sufficient supply of gold to provide for adequate strength and growth considering our possible necessities and probable opportunities.

You have in your mind a very distinct apprehension that through the amendment that we have often discussed the character of the Federal reserve note might be destroyed; that we might interfere with "the unique excellence of the note provisions of the Federal Reserve Act which provide a maximum of elasticity with a minimum of danger of over-issue". I give you below a condensed statement of all Federal Reserve Banks as of last Saturday; and underneath you will find the same condensed statement as it would look if our amendment had gone through:

(I)

FEDERAL RESERVE BANKS
(in million dollars)

Assets:		Liabilities:		
Gold	432	Capital	56	
Paper	110	Govt. & member deposits	580	
Other investments	108	Federal Reserve notes	14	
	650		650	Res. 72.9 Dep.& note

Federal Reserve Agent:

Gold	214
Commercial Paper	14
	228

(II)

Assets:		Liabilities:		
Gold	646	Capital	56	
Paper	110	Deposits	580	
Other investments	108	Notes	228	
	864		864	Res. 77.4 Dep.& note

Federal Reserve Agent:

Collateral:	(Gold	214
	(Comm'l paper	14
		228

I wish you would show me how there would be any quicker redemption under (I) than there would be under (II). In effect they are absolutely alike. No matter how we keep our books, there are in effect in both cases $244,000,000 Federal reserve notes outstanding, of which $230,000,000 are secured by gold and $14,000,000 by commercial paper. If this paper is collected at maturity the entire $244,000,000 will be covered by gold. If any Federal reserve notes are actually presented for redemption, nobody could tell whether the originally gold secured notes or the paper-secured notes are paid for. The individual outstanding notes today have no ear-marked collateral of paper or gold. They are in effect secured by both; and all our amendment proposed was a clarification of a condition which, as a matter of fact, exists already today.

Elasticity is a question not of the individual notes but of the aggregate volume of outstanding notes and (the simple substitution of Federal Reserve notes for gold circulation leaving the volume unchanged) this volume is controlled by the increase or decrease of the Federal Reserve Banks' investments. No matter whether or not a Federal Reserve note is held in a member bank's vaults as reserve or is circulating in the pockets of the people, it will be redeemed and converted into gold whenever the Federal Reserve Banks collect their investments. I cannot for the life of me see how the redemption of Federal Reserve notes takes place faster in one case than in the other. It follows automatically the collection of the Federal Reserve Bank's investments.

You say:

> "It is unthinkable that twelve banks should be in a position to issue notes which would be available as reserve money - in other words, that there might be twelve varieties of bank reserve money, similar in nothing but appearance and the fact that they bore the indorsement of the United States Government."

I had hoped very much that you could follow the reasoning contained in my Kansas City speech that, in dealing with member banks, we should stop talking of reserve money, which indeed is an "obsolete" manner which is not even found in England, which you have chosen as your model. Bank balances and vault money are carried there indiscrimminately in one item. Whatever is good enough for the public to accept as current money is included in the item "Cash and bank balance" by English banks, and, for that matter, by French, German and other banks. When the Peel Act was suspended in England and notes were issued by the Bank of England against any kind of security there was not a bank in England that would not include Bank of England notes in the item "Cash and balance with the Bank of England". One note of the Bank of England was treated like any other note of that bank. There was no differentiation between those issued against gold and those issued against securities. As a matter of fact, there always has been a certain amount of government securities against Bank of England notes and that never has prevented the English banks from counting those notes as cash. Today, when there are outstanding $650,000,000 of currency notes issued by the British Government, with a gold cover of 21.6%, these currency notes are included in "Cash and balance with the Bank of England" together with Bank of England notes, even though these currency notes are secured by only so small an amount of gold cover and the remaining cover consists of government securities, while our Federal Reserve notes are secured at present by about 100% of gold. No matter what Hartley Withers may say about the desirability or probability of making the Bank of England note a pure gold note at the end of the war, I believe that nothing of the kind will happen and that, quite the contrary, as the probable development we may much rather expect at the end of this war that the Bank of England will be reformed to correspond more to the continental systems with an elastic note issue. Sir Edward Holden's speech on this point is very instructive. As a matter of fact, he had worked out a plan for the English member banks to assemble additional gold reserves (for the very reason that the Bank of England, under its present organization, is not able to control a sufficient amount of gold) and, in time of emergency, to deposit this additional gold with the Bank of England and make it the basis of an elastic note issue on the continental plan. Whenever this plan were carried out, the Bank of England notes would be part and parcel of the item "Cash and balance with the Bank of England."

I fail to see any sound reasoning in Hartley Withers' contention. When the bulk of the British banks' "reserves" consist of balances with the Bank of England, which are never fully secured by gold (at present they have a reserve of about 23%), why should the Bank of England note not be included in "Cash and balance with the Bank of England" unless it were secured by 100% gold - which it never was?

But, to return to your argument: If you object to 12 varieties of reserve money, how can you justify that the total reserve of a member bank may be kept as balance with one of the 12 Federal Reserve Banks - balances which in that case are not guaranteed by the United States? Are these not 12 different varieties of reserve money, much poorer protected reserve money at that than the obligation of the United States! Moreover, are you quite justified in saying that these notes are

> "similar in bothing but appearance and the fact that they bore the indorsement of the United States Government"?

Is it not a fact that these notes are absolutely identical all over the country except that there has been printed upon them the seal of the respective Federal Reserve Banks to make them distinct as to the point of redemption? In the pockets of the people they are absolutely the same identical instrument. The only difference is that when they come back to the issuing Federal Reserve Bank it may not pay them out. They are not <u>indorsed</u> by the United States. They are the <u>obligation</u> of the United States, and, furthermore, they are alike in this, that there must be held against all of them at least 40% of gold. As far as the member banks are concerned, all these notes are alike. They can present them for payment wherever they please and whenever they hold them they hold the sacred obligation of the United States to pay in gold.

Your paper proceeds on the theory that the Federal Reserve System has been fashioned upon the British as against the Continental systems; that the British system is good and ought to be imitated by us; that the Continental systems are bad, or anyhow that they would be bad models for our Federal Reserve System.

I have to take issue with both of these points. The most characteristic difference between the Bank of England and other central banks is that the Continental banks have an elastic note issuing power while the note issuing power of the Bank of England is rigid. The very object of the Federal Reserve Act was to provide for an elastic note issue and this note issue was copied from the Continental banks. We had a rigid note issue before the enactment of the Federal Reserve Act and were subject to all its fatal consequences. Are you not blowing hot and cold? On the one hand you consider the Federal Reserve System, with its elastic note issue, a great advance made by the United States, and correctly so. On the other hand, when conclusions are to be drawn, and when we ought to benefit from the experiences of the very countries which developed this method of the elastic note issue, you cling to the principles and the experiences - and bad experiences at that - of the rigid note issue country and, in doing that, you can only create an unfortunate confusion.

I do not want to go too closely into your paper, but it appears to me that the parallel between England and the United States is poorly chosen for the additional reason that, while you say the bank note has become obsolete in England, you cannot possibly say the bank note has become obsolete in the United States, where there is a per capita amount of $42 of money. It is not a question of whether or not the bank note becomes obsolete, but it is the question, whether or not the use of money becomes obsolete. If I understand you correctly, what you mean is that in England so much is being paid by check that the actual use of money has become an unimportant feature, and the check has taken its place. But that certainly cannot be said of us. No doubt the check plays a large part but, in spite of that, we have a large volume of money in circulation and a large fluctuation in the volume of money caused by such processes as crop movements, which do not affect England. Moreover, I think you under-estimate on the other hand the amount to which clearings and giro are used on the Continent, tending to reduce the use of actual money. You will find attached a statement of the amounts of obligations that have been settled in Germany either by the giro system or by clearings or by postoffice transfers or postoffice checks. Moreover, as you know, there is a movement afoot in Germany to encourage the use of checks, a process which has been started on several occasions but which unfortunately, by reason of a petty fiscal policy of putting a stamp tax on checks, was killed upon each occasion. I mention this only for the purpose of adding that even after the check system is established in France and Germany you will find that there will not be any difference in their method of handling notes. The notes of the Banque de France and the Reichsbank will continue to be counted as cash together with the balance with the central banks.

I should be very much mistaken if, after the war, there would not be a strong development in all now belligerent countries to use the check and to use the bank note as the means of payment of internal debts. The check and the bank note will both act as "yard sticks" and as media of clearing; the gold will be concentrated in the central banks in order to be available for the settlement of international debts.

I think, dear Doctor, you are moving between two extremes. On the one hand, you are a passionate advocate of the highest development of the use of checks. You have sometimes gone so far as to call the check a "means of currency." On the other hand, however, you appear to me to be an advocate, not of the bank note, but of the gold certificate or actual gold circulation. While I am in full accord with you as to the desirability of the development of the check system, I am distinctly opposed to the wasteful method of using the gold itself as a means of exchange; that is to say, actual barter in each case, actual value, instead of using the "yard stick", the check or the bank note which are obligations to pay in actual money.

I know that you and I are in accord that at this time, when we have grown so tremendously rich and strong through the misfortune of others, it would be nothing less than a crime to build around the United States a high tariff wall so that we may hold all we have taken and prevent any part of it from going back to Europe by having goods sent here that, in spite of her handicap, Europe will be able to produce cheaper than we. And I think you and I, furthermore, are in accord that the same point of view ought to be taken when we are dealing with the question of our gold position and banking power. Simply because we should have neglected to organize our wealth and because we insist upon squandering our gold all over the country we should not be in a position of being niggardly or provincial when the time will come for us to do our full share in the reconstruction and further construction of the world. We should not entertain the eventuality of raising our discount rates so high that our own securities should go back to Europe, as you appear to contemplate, or so as to kill the new acceptance business with which we have begun to finance the world, and incidentally of throwing a damper on our whole home situation by a policy of rigid contraction.

Again let me say that I do not want to prophesy and ultimately such conditions may arise, but they should not occur any earlier than necessary because of our neglect to take the most elemental precautions in assembling our gold.

Even though some of the foreign loans maturing in the next years will not prove to be weapons of defence because they are secured by our own collateral which will be expected to liquidate them before they mature, we are no doubt strong enough to be able to protect ourselves. But, as I said, I do not believe that we want to be protectionists to a degree which would be harmful to ourselves and to the entire world because we neglected to prepare.

I believe that you will say that you are in full accord with me with respect to these objects and aims and that we differ only slightly as to the methods, and that, after all, your main objection is based upon your fear of the over issue of notes. But, as I showed you before, this over issue on a basis of 2 or 3% of till money could only be a very restricted one. Moreover, this objection could be met by limiting to a definite percentage the amount of till money kept in Federal Reserve notes. Personally, I should be satisfied to have this percentage fixed at 2½ or 3% as against the 5% contained in our last recommendation to Congress. At the same time, I should favor beginning the tax on the notes whenever the gold cover fell below 70%. These would be two very important brakes upon any tendency to over issue on account of an excessive amount of Federal reserve notes kept in vault, but, in addition to that, you must trust to the sound judgment of the Federal Reserve Banks to keep the system safe and sound. If you have not that confidence, you could not possibly under-take to urge the member banks to place their excess balances with the Federal Reserve Banks. As a matter of fact there is at this time, after two years of operation, a very clear understanding on the part of the Federal Reserve Banks that their normal reserves ought to be between sixty and eighty per cent, and our system is being run on that basis.

You cite some foolish suggestions that were made by bankers from time to time as an illustration of the dangers to which the system would be exposed. I think the argument ought to be reversed. The fact that these foolish suggestions were turned down with contempt and ridicule is the best proof that, on the whole, the common sense of the banking community can be trusted. The danger remains, of course, that they may want to go far in business expansion, but there you have to rely upon the ability, intelligence and conscience of the Federal Reserve Board and the Federal Reserve Banks. If these are lacking, the country will have to pay the price whether or not the Federal reserve notes are counted as reserve. But I, for one, believe that the further we get along the better understood will be sound banking principles and the easier will it become to secure for the banks and for the Board men capable of handling the situation. The constant publicity to which the system is subjected is, in itself, an important safeguard.

You cite present European conditions as indicating the possibility of inflation under a central banking system. I should cite them to you as proofs of the most effective instruments of protecting a country under tremendous stress. As a matter of fact, the danger in these countries is not so much from currency expansion as the tremendous growth of their national indebtedness. But that an elastic note issue under conditions such as govern Europe at this time is an absolute necessity will not be denied by you, and it is proven by the fact that even England had to take recourse to this means by issuing an unsecured government note circulation.

In conclusion, let me state frankly to you that I think you are "seeing ghosts" when you believe that Federal Reserve notes as reserve would prove to be the undoing of the regional system. Quite the contrary, it would be the making of it. It would strengthen the banks and make them independent.

You say:

> "It would be the first step toward the process of substituting the principle of centralism in our banking system for the principle of regionalism."

The principle of centralism has been introduced by the creation of the Federal Reserve Board through its power to make one bank rediscount for the other; through its power to regulate interest rates all over the country, and, furthermore, through the very creation of one Federal Reserve note issue which circulates all over the country without any differentiation. These Federal Reserve notes are the obligations of the United States, and the Act prescribes:

> "The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs and other public dues."

Is it at all plausible to contend that this Federal Reserve note is a regional note when the law obligates all member banks all over the country to accept it? I think it is belittling the Federal Reserve System if you should consider that a step of this kind would be a "perversion of its most fundamental principle."

You furthermore say:

> "As such, I cannot but view it with the most serious apprehension. The regional principle is the vital principle in our new banking system. It is America's specific contribution to the business of reserve banking. A banking system is a growth and development, and the regional principle, which is the life giving force of the Federal Reserve System, grew out of the clearly perceived necessity of adapting the structure of any system of reserve banking which would fit American conditions to the analogies of our political and economic life and the genius of our people."

The regional feature of our system is a necessity; not a beauty. The time may come when, after generations, our country may enjoy a central banking system as safely as do European countries at this time. In view of our political conditions and our peculiar economic conditions, a system was thought preferable that would insure a certain degree of decentralism. It is in response to this necessity that the regional system was adopted, but the creation of a system of distinct Federal Reserve Districts and Federal Reserve Banks would have been an absolute failure had they not been welded together in one strong unit by the cooperation secured through the Federal Reserve Board and by placing behind the whole system - in order to eliminate the weakness caused by the creation of comparatively unimportant Federal Reserve Banks - the great power of the United States. This led to the issue of Federal Reserve notes by the Government instead of a bank note issue as in Europe. It was done for the very reason of uniting the banks and not for the purpose of separating them. The objects and aims of those who want to further the development of this principle of regionalism must be to overcome the difficulties that are caused by the many headedness of the system; to overcome the weakness, as far as it can possibly be done, and to create the greatest possible confidence by dealing with the system as a whole instead of dealing with twelve distinct institutions, including some pretty weak brothers. It is from this point of view of immeasurable advantage to use this common note issue, which is backed by the strength of the United States, as a joint instrument to strengthen the whole system and to give it a power that no individual reserve bank could possibly enjoy.

The measures proposed for the strengthening of the gold and credit power of the Federal Reserve Banks are the most important steps that could be taken in that direction. They would make for the independence of the districts, and they would tend to give to the United States as a whole that great banking power that would enable us in safety to cope with the problems that lie ahead of us.

I append a folder containing some of the letters and public notices received in response to my Kansas City speech.

Very truly yours,

(Signed) Paul M. Warburg.

Hon. A. C. Miller,
Federal Reserve Board,
Washington.